

# Market Directions

Post GFC Edition | Summer 2009/10

# M &A

Experts in conducting  
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## 1. How has the GFC impacted demand for large, privately owned businesses?



Not surprisingly, the Global Financial Crisis caused a sudden and dramatic curtailment of business acquisition activity, worldwide. After the failure of Lehman Brothers in September 2008, and during the subsequent mayhem on international commodity and share markets over the following 6 months, buyers were fighting fires on the home front and all non-core activities, including business acquisitions, were quickly relegated to the backburner.

Our experience at Mergers & Acquisitions was typical of many other corporate advisory firms during this period. On the 1<sup>st</sup> October 2008, our firm had five large private business sale transactions underway. By the 31<sup>st</sup> October 2008, all five deals had fallen over because of the sudden escalation of the GFC. It would be a full eleven months later, as confidence started to return to the markets, before we completed another business sale transaction.

For most Australian Stock Exchange listed companies, 2009 was a period of consolidation. Many companies had completed multiple business acquisitions in the boom years leading up to the GFC, and this often caused disruptions as they scrambled to integrate all of these into their existing businesses. In addition, most listed companies found themselves under pressure as predicted revenues and profits from recent acquisitions, as well as their existing businesses, failed to live up to expectations.

On a brighter note, most financial commentators agree that the world is now well and truly in recovery mode. Australia's economy is recovering faster than most other countries, largely due to a resurgence of the resource sector evidenced by the development and expansion of many new and existing LNG and mining projects.

As a result, large numbers of ASX listed companies, well managed private equity firms and overseas buyers are now back in the market looking to acquire quality businesses. Mergers & Acquisitions is speaking to many of these buyers and they are seeking to acquire businesses exposed to resources and other growth sectors.

Similarly, many Private Equity firms suffered from severe indigestion as a result of taking on large amounts of debt to fund some of their acquisitions. The consequences of paying too much and borrowing heavily has severely tested the viability of many Private Equity firms as falling revenues and declining cash flows hit their investments.



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## 2. Many listed company share prices have fallen sharply. How has this impacted on the value of large privately owned businesses?

Many business owners want to know how the dramatic fall in listed company share prices have affected the value of their business. The short answer is that large private business values have not fallen as much as one might expect.

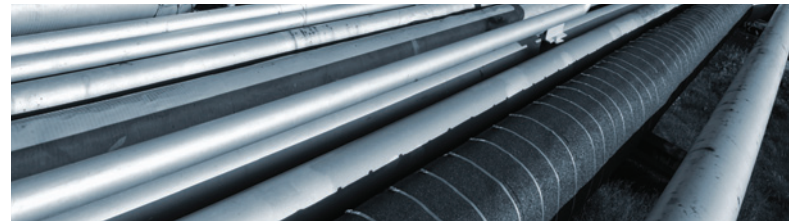
“...large private business values have not fallen as much as one might expect.”

Listed company share prices tend to be more volatile than prices of privately owned businesses for one important reason. Listed Company share prices are influenced not only by the underlying performance and future prospects of the businesses they own, but also by the amount of debt owed by the company. In some extreme cases the reduction in earnings brought about by the GFC caused the value of their businesses to fall below the amount of debt owed by the company. At that point the net shareholders equity of the Listed Company was less than zero, and the share price fell quickly to reflect that reality.

This explains how the share price of a listed company with real operating businesses can fall to almost nothing, even though the businesses themselves still might have considerable value.

Very few businesses actually sold during the dark days of the GFC so it is difficult to gauge the degree to which EBIT multiples were affected during that extraordinary time. Many purchasers were trawling for bargains during this period but not many deals were actually concluded. Owners of very good businesses simply would not sell their business unless there were extenuating circumstances, such as being forced to pay margin calls on their sinking share portfolio's.

This highlights another fundamental difference between listed company shares and stakes in privately owned businesses. Listed company shares are usually held by many thousands of individual shareholders and they are (usually) easily bought and sold on the stock market. The shares are said to be very “liquid” and the price can fall very quickly if a large number of investors fear the company is in trouble. In contrast, owners of private businesses usually do not have to sell, and indeed will not sell, if the price and conditions being offered are unattractive.



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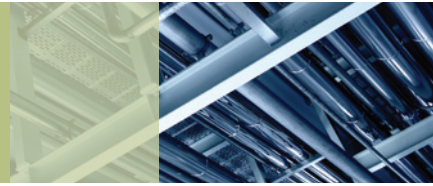
Now that the worst of the GFC appears to be behind us, buyers are still cautious but confidence is rapidly returning. Valuation multiples are stabilising and we estimate the average EBIT multiple for medium-to-large, privately owned businesses has probably settled back near the long-term average range.

Some businesses will sell for less than the average, and some higher, depending on the type of business, demand for the particular type of business at that time, buyer's expectations of earnings growth potential, and many other reasons. However, as we saw before the GFC, really exceptional businesses will still command earnings multiples above the average.





### 3. Will I achieve a good price if I sell now, or should I wait?



After suspending virtually all business acquisition activity for 12 – 18 months, many listed companies are now eager to re-activate their acquisition plans. Many are now in a much stronger position having strengthened their balance sheets through equity issues and asset sales to reduce gearing, whilst simultaneously closing or reorganising unprofitable business units.

**“...buyers can now see with perfect hindsight how the business they want to buy has performed throughout the GFC.”**

Not only has the financial position of buyers stabilised and improved, they can now see with perfect hindsight how the business they want to buy has performed throughout the GFC.

Nearly every business has been impacted in some way by the GFC, so buyers are not alarmed when they see a dip in revenue and earnings over the last year. Buyers are more concerned with a business’ future prospects and likely earnings growth in FY2010 and beyond.

It is true that prices being paid now are a little less than what may have been achieved in the boom prior to the GFC. However, it is interesting to learn from an analysis of hundreds of business acquisitions made by a large number of listed companies in the boom leading up to the GFC, that many so called “high priced sales” were illusory and not so high priced after all. Very few sellers were paid 100% in cash, and most accepted some shares in the buyer’s company as part consideration for the sale. When the prices of those shares fell, many sellers ended up with effective sale prices more or less equal to the average long-term EBIT multiples.

**“...buyers are once again willing to pay premium prices for top quality businesses with excellent growth prospects.”**

Recently, we have noticed that sellers who are willing to take shares in the buyer’s company as part consideration for the sale now view those shares as being offered at prices they judge to be closer to fair value.

Mergers & Acquisitions are currently working on a number of large business sale assignments, both within Australia and overseas, and we are pleased to report that buyers are once again willing to pay premium prices for top quality businesses with excellent growth prospects.





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## 4. Are you thinking of selling your business?



If you are thinking of selling your business, either now or in the next few years, please contact us for a confidential discussion.

Buyers we are in contact with include overseas buyers attracted by Australia's strong economy, selected private equity funds that raised cash prior to the GFC and are yet to find a suitable investment, and many listed and unlisted Australian Companies with cash and/or low gearing that see signs of a recovery as an opportunity to aggressively grow their market share.

### Buyers are prepared to pay premium prices for outstanding businesses with:

- Future Maintainable Profits between \$1 million & \$30 million p.a., or higher
- Strong market position with sustainable competitive advantage
- Leading products and/or services
- Good track record and sound financial history
- Capable management and/or key employees
- Excellent growth prospects

### Businesses of special interest are those operating in the following sectors:

- Suppliers of goods and/or services including equipment repair to oil & gas, particularly LNG and CSM industry, and also mining industry
- Wholesalers of consumable goods, equipment or spares to industry
- Manufacturers of quality goods

For more information about Mergers & Acquisitions, and to view details of our past successful transactions, please visit our website [www.mergers.com.au](http://www.mergers.com.au)

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